The Back to School Issue

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With some anxiety, we watched our five-year-old daughter walk up to the school bus yesterday morning, on her way to the first day of kindergarten. As she climbed aboard, we overheard one of her classmates ask, “Is that your grandfather?”

As a pesky questioner ourselves, we admired the young boy’s pluck. Although it injected a mild stinger into our post-Outer Banks bliss, we realized the moment could have been considerably worse: our child’s mother could have been the object of his inquiry.

This week also kicked off our own probing into the loan market’s true identity. What will the fourth quarter bring? Are we headed for an investor-friendly correction? Will loans echo the bullish state of the public markets? Whither pricing? Fund flows? Deal flow?

Let’s take these one at a time. As we’ve discussed in previous columns, all signs point to an ongoing seller’s market – very liquid, but measured. Private equity sponsors need to put money to work, and the best will do so with aggressive structures and pricing. But story credits will still require more yield, and tighter covenants.

Institutional cash is leaking from retail loan funds, though at a slower pace. By the numbers (per Lipper/S&P), roughly $10 billion has flowed out of accounts over the past five months, after almost two years of in-flows amounting to about $67 billion.

Contrast that with high-yield dollars which, after a staggering $7.1 billion departed in early August, have reversed course to the tune of an in-bound $3.5 billion over the past three weeks. Seems as if investors are equally comfortable with fixed-income and floating-rate assets.

Calendar often determines pipeline. With Labor Day in the rear-view mirror, arrangers are finalizing terms for deals to be launched before the end of the year. It’s not too late for new buyouts to get into the queue, but since pre-launch diligence can take eight weeks, and syndication another month, the 2014 window will soon begin to close.

On the supply/demand front, M&A shops report strong PE bidding activity, foretelling robust 4Q deal flow. That, in conjunction with plenty of cash on investor balance sheets, fresh capacity from newly minted CLOs, and large cap funds hungry for yield, all point to a relatively balanced outlook on pricing.

For example, a typical new-issue, single-B-ish, broadly syndicated, term loan B would be priced now at Libor plus 400 bps with a 1% Libor floor and 99.5 OID. We expect all-in pricing for that profile will remain within 25 bps, give or take, for the balance of the year.

Similarly, a middle market loan comes in today at Libor plus 450-500, with a 1% floor and 99 OID. Subject to size and sector, pricing should stay in this range for a while.

You may be wondering how our daughter answered the question posed to her at the bus-stop. Displaying her characteristic flair for the undramatic, she looked back at us briefly, and replied, “No, that’s just my dad.”